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IN THE

Supreme Court of the United States

OCTOBER TERM, 19__

No. _____

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt,

Petitioner,

versus

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT.

To The Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt, petitions for the issuance of a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit to review its Judgment entered in the above titled cause on May 25, 1965.

OPINION OF LOWER COURTS

1. The opinion of the Court of Appeals for the Fifth Circuit in this case United States of America v. John

Nicholas, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt is reported in 346 F(2) 32. A copy of that opinion is contained in the Transcript of Record, page 33, and is also reproduced as Appendix A attached to this Petition. The Court of Appeals decision was on an appeal from an order of the District Court which affirmed a Referee in Bankruptcy. There were no formal opinions by either the Referee or the District Judge. The Order of the Referee is at page 19 of the Record and the Order of the District Court on Review is at page 25 of the Record.

JURISDICTION

1. The Judgment sought to be reviewed was entered by the United States Court of Appeals, Fifth Circuit, on May 25, 1965, 346 F(2) 32, and a timely Petition for Rehearing was denied by that Court on July 9, 1965 (R. 76).

2. Jurisdiction of this Court for this Petition for Writ of Certiorari is invoked on the basis of 27 U.S.C., Section 1254(1), and also Supreme Court Rule 19.1 (b), permitting Certiorari to Courts of Appeal when there is a conflict of opinions between the various Circuit Courts of Appeal. Petitioner contends the decision by the Court of Appeals for the Fifth Circuit in the instant case is in direct conflict with that of the Court of Appeals for the Eighth Circuit, in **United States v. Jerome Kalishman, Trustee in Bankruptcy of Seymour Wallas and Company, Bankruptcy**, 346 F(2) 514 (CA 8, June 4, 1965), hereinafter designated the "Kalishman" case, App. C.

Further, this Court has jurisdiction to review the decision in question by virtue of 11 U.S.C.A., Section 47(c).

QUESTIONS FOR REVIEW

1. Whether the United States is entitled to recover from the assets of a bankruptcy estate, as part of a cost-of-administration claim, interest to date of payment on a claim for unpaid withholding taxes, FICA, FUTA and cabaret excise taxes, incurred by a debtor-in-possession, while operating a business during the pendency of an arrangement proceeding under Chapter XI prior to adjudication.

2. Whether a trustee in bankruptcy is liable for penalties for failure to file tax returns for the cabaret excise tax, FUTA tax and FICA-withholding taxes when the taxes were the liabilities of a predecessor debtor-in-possession.

STATUTES INVOLVED

The Statutes and Regulations involved in the consideration of this matter are listed below and set out verbatim in Appendix B.

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A. **The Acts of Congress relating to Bankruptcy:**

11 U.S.C., § 75(a) (Sec. 47a—Bankruptcy Act) Trustees; duties. 8

11 U.S.C. §104 (Sec. 64 Bankruptcy Act) Debts which have priority 10

11 U.S.C., §778 (Sec. 378 Bankruptcy Act) Procedure upon order directing that bankruptcy be proceeded with. 13

B. **The Internal Revenue Code of 1954:**

26 U.S.C., §3504, Acts to be performed by agents. 14

26 U.S.C., §4231(6), Cabarets. 14

26 U.S.C., §6011(a), General requirement of return, statement, or list. 15

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C. **The Judicial Code**

28 U.S.C., §960, Tax liability 17

D. Treasury Regulations on Employment Tax (1954 Code) 31-601(a)-1. 17

STATEMENT OF THE CASE

On August 6, 1958, the Beachcomber Motel, Inc., filed a voluntary petition for an arrangement with its unsecured creditors, under Chapter XI of the Bankruptcy Act. On September 17, 1958, upon its failure to submit a Plan acceptable to its creditors, the corporation was adjudicated a bankrupt. Between August 6, 1958 and September 17, 1958, the business had been operated by

the debtor-in-possession under the authority of the Bankruptcy Court.

The United States filed a claim for taxes in the subsequent bankruptcy proceedings (R-13). Included in the claim were pre-petition taxes accruing prior to August 6, 1958, the date of the filing of the Chapter XI and also a part described as "administrative expense taxes" which were for taxes that accrued during the debtor in possession period, between the date of the filing of the petition for arrangement and that of the entry of the order of adjudication on September 17, 1958.

The trustee in bankruptcy readily admits the propriety of allowance of pre-petition taxes and also the principal portion of the "administrative expense taxes". The Trustee objects to the portion of the claim of the Government which requests post adjudication interest and penalties on the "administrative expense taxes".

The debtor in possession incurred administrative tax liability to the United States in three areas: $519.89 for withholding and Federal Insurance Compensation Act (FICA) taxes; $644.00 for Cabaret or excise taxes; and, $362.29 for Federal Unemployment Tax Act (FUTA) taxes.

The Government, in addition, claimed assessed interest, accrued interest and assessed penalties on each of these particular taxes (R-13). The interest was claimed not only to the date of filing of the claim on April 11, 1963, but also thereafter until date of payment of the taxes. The assessed penalties were for alleged failure of the trustee in bankruptcy to file the respective tax

returns required of the taxpayer for the three tax liabilities.

The trustee in bankruptcy objected to that part of the Government's claim which sought penalties and accrued interest and interest to date of payment of taxes, all of which were post-adjudication impositions (R 16-21). The Referee sustained the objection and denied the Government's demand for interest to date of payment and penalties and allowed as an administrative expense the principal balance of the three taxes and assessed interest. The Referee was affirmed by the U. S. District Court and the Court of Appeals for the Fifth Circuit reversed.

It is the order of the Court of Appeals, Fifth Circuit, which the Trustee petitions this court to review on certiorari.

Jurisdiction of the federal courts below is based on their administration of the Bankruptcy Act, 11 U.S.C. § 1 et seq., proof and allowance of claims, 11 U.S.C. § 93, Bankruptcy Act § 57, review by the District Court of Orders of the Referee, 11 U.S.C. § 67, Bankruptcy Act § 39, and the Court of Appeals review as authorized by 11 U.S.C. § 47, Bankruptcy Act, § 24.

REASONS FOR ALLOWANCE OF WRIT OF CERTIORARI

INTRODUCTION

As has been noted, essential jurisdictional basis for this petition is the conflict of this decision with an almost simultaneous holding in the Court of Appeals for the

Eighth Circuit which disallowed the interest on withholding taxes that were allowed by the judgment of the Fifth Circuit.

The judgment on review from the decision of the Fifth Circuit and the decision of the Court of Appeals for the Eighth Circuit in U. S. v. Kalishman, 346 F(2) 514 App. C., decided June 4, 1965, both considered the status of claims by the United States for interest on withholding taxes that were incurred by a debtor in possession in a debtor relief proceeding under Chapter XI of the Bankruptcy Act. In both cases, the Chapter XI proceeding had been terminated, and superseded by a liquidating bankruptcy.

The Court of Appeals for the Fifth Circuit upheld the government's claim for post-adjudication interest and the Eighth Circuit denied such interest, leaving an unresolved conflict between the two decisions in the two Circuits.

In the case at bar, the issues also include the allowability of interest on FICA, FUTA and Cabaret taxes, as well as the question of responsibility of a trustee in bankruptcy to file returns for those various taxes on behalf of the debtor in possession after the debtor in possession administration had terminated. These additional features do not alter the legal principles applicable to both this case and the **Kalishman** decision.

In both conflicting decisions, the sums of money involved are relatively small, however the impact of the rule of allowing post-adjudication interest on claims in

bankruptcy compels the trustee to seek review in this court for resolution of the conflict.

The allowance of post adjudication interest on any claim in bankruptcy has generally been recognized as inequitable and a source of administrative difficulties. The practical problems inherent in allowing post-adjudication interest up to date of payment notwithstanding the specific allocations of priorities under the Bankruptcy Act is a consideration that usually persuaded the courts to deny claims for such interest.

The government's claims in this instance are accorded a specific priority under Sec. 64(a)(1) of the Bankruptcy Act. The effect of the decision of the Fifth Circuit in this case accords to the government a position superior to that specifically provided in the Bankruptcy Act. In effect, a super-priority is created which either requires the government's claim to be paid prematurely or allows a singular and unprecedented accumulation of interest until the claim is paid, notwithstanding the government's position on a well defined ladder of priorities.

I. THE BANKRUPTCY ACT SPECIFICALLY ALLOCATES PRIORITIES TO TAX CLAIMS AND A DEPARTURE FROM THE PRIORITIES OF THE ACT SHOULD BE AVOIDED IN FAVOR OF GIVING PRECEDENCE OF THE BANKRUPTCY ACT OVER OTHER STATUTES.

The inter-relation of the Bankruptcy Act and the Internal Revenue statutes was considered in City of New

York v. Saper, 336 U.S. 328, 69 S.Ct. 554, 93 L.Ed. 710 (1949), with this observation:

> "We do not believe the revenue act of 1924 and similar enactments were intended to amend the comprehensive scheme of the Bankruptcy Act. ..."

The **Saper** case was a thorough treatment of the then existing bankruptcy statutes in their relationship to tax claims. Specifically, the **Saper** case decided that prepetition tax claims could not earn post petition interest in a liquidating bankruptcy. The purpose of bankruptcy proceeding being to collect the assets of the debtor and equitably distribute them to the creditors in accordance with prescribed priorities of the Act requires judicial determination that taxes accorded specific priority by Sec. 64 of the Act should be distributed in accordance with that particular statute. **Guarantee Title & T. Co. v. Title Guaranty & S. Co.**, 224 U.S. 152, 56 L.Ed. 706, 32 S.Ct. 457, considered the application of internal revenue statutes to bankruptcy proceedings. The government claimed that Sec. 3466 of the Revised Statutes governed bankruptcy distribution. The opinion rejected the government's position. **Davis v. Pringle**, 268 U.S. 315, 45 S.Ct. 549, 69 L.ed 974, was another attempt by the government to invoke provisions of Sec. 3466 of the Revised Statutes in an attempt to afford priority to tax claims under Sec. 64(a)(5) of the Bankruptcy Act. At that time, Sec. 64(a)(5) gave a fifth priority to "debts owing to any person who by the laws of the state or the United States is entitled to priority."

Other authority for the preference in application of

bankruptcy statutes over other Federal Statutes in bankruptcy proceedings is contained in **Adams v. O'Maley**, 182 F(2) 925 (8th Cir. 1950); **U. S. v. Bradley**, 321 F(2) 224 (CA 5, 1963); compare, also, **4 Collier on Bankruptcy**, § 67.24, page 239.

The logic behind such a rule is obvious and persuasive. If the intent of Congress expressed in its establishment of priorities under the Bankruptcy Act is to be followed, then distributions must be orderly and in accordance with those priorities, unless there is a clear, specific legislative expression to the contrary. General tax revenue statutes have not been used as a basis for altering the Bankruptcy Act's specifically prescribed outline of distribution. The allowance of interest on a tax claim after adjudication would constitute such an alteration and should not be permitted.

II. ALLOWANCE OF POST-BANKRUPTCY INTEREST ON TAX CLAIMS IS INEQUITABLE TO THE OTHER CREDITORS AND ADMINISTRATIVELY BURDENSOME.

The inequitable and impractical nature of allowing post-bankruptcy interest on any claim, tax or otherwise, is recognized in **City of New York v. Saper**, supra, which is the leading authority for the disallowance of post petition interest on tax claims. The **Saper** case involved taxes that accrued prior to the bankruptcy proceeding, unlike the taxes under consideration here. However, this is not a distinguishing feature. The controlling similarity of this proceeding with that in the **Saper** case is that in both situations the court deals with liquidating bankruptcies under Chapters I through VII of the Act. The rationale

of the **Saper** case is as much applicable here as it was in the proceedings then before this Court. The essential reasoning of the **Saper** case is that it is inequitable to allow the government interest on funds while those funds were in the hands of a trustee in bankruptcy.

Additionally, of course, **Saper** further recognizes the principle that liquidation of estates in bankruptcy requires that continuing obligations must cease at some point and debts be determined for the allocation of priorities and distribution. Otherwise, sound administration and distribution of dividends is impossible. See 3 **Collier** on **Bankruptcy**, § 63.16(2). Section 64 of the Bankruptcy Act awards a specific priority for taxes, whether they be pre-petition taxes accorded a fourth priority under Sec. 64a(4), or administration expense taxes accorded a first priority under Section 64a(1). The taxes are claims which should be treated as claims and accorded their respective priorities as directed by the Bankruptcy Act. The reasoning of **Saper** is followed in **United States v. Edens**, 342 U.S. 912, 96 L.Ed. 682, 72 S.Ct. 357, and also in **United States v. General Engineering & Manufacturing Co.**, 342 U.S. 912, 96 L.Ed. 682, 72 S.Ct. 358. **United States v. Edens**, supra, is a decision affirming a Fourth Circuit decision reported at 189 F(2) 876, in which the Court of Appeals recognized the inequitable nature of allowing interest on tax claims and held this rule applicable in reorganization proceedings as well as in straight bankruptcy proceedings. The Court stated that no single class of creditors should be able to benefit at the expense of another class of creditors, particularly when any delay in payment of claims was caused by application of an act of Congress and not by dilatory activities on the part of the taxpayer. This opinion strikes directly at the reason

assigned by the government in the instant facts for the timely payment of its taxes and the assertion that interest should be approved as a penalty for that non-payment. If the rule urged by the government is permitted to stand, it is not the trustee who is penalized for the non-payment, but the other creditors who have no control over the date of the payment of taxes. The inequitable and impractical effect of requiring interest on claims in bankruptcy proceedings, whether in reorganization proceedings or in straight bankruptcy, is well accepted and has received thorough recognition in all of the Federal decisions since that in the **Saper** case. Recently, the Court of Appeals for the Fourth Circuit, in **Smith** v. **Robinson** (CA 4 1965), 343 F(2) 793, denied post-petition interest on tax claims in a Chapter X proceeding, citing as authority **City of New York** v. **Saper,** supra, and other cases holding in accord therewith. The Fourth Circuit also, in **United States** v. **Harrington,** 269 F(2) 719, recognized the rule against post-petition interest on tax claims in order to prevent inequities and the suffering of other creditors because of that interest payment.

In addition to the statutory basis for denial of post petition interest, there of course exists in bankruptcy administration the inherent power of a bankruptcy court as a court of equity to determine how a debtor's assets should be distributed and it has generally been held that inequality results from payment of interest on obligations. A specific example is contained in **Vanston Bondholders Protect. Com.** v. **Green,** 329 U.S. 156, 91 L.Ed. 162, 67 S.Ct. 237, in which bondholders were denied interest notwithstanding their contractual obligation because of the inequitable result of denying such interest payments to other creditors with claims of equal dignity.

The *ratio decendi* of **Saper**, supra, the **Vanston Bondholders** decision, supra, and the other authorities supporting the repudiation of the inequitable result of allowing post adjudication interest on claims in bankruptcy, coupled with the administrative burden of calculating such interest has persuaded the courts to deny post-adjudication interest. This reasoning and proposition was, of course, well recognized by the Eighth Circuit in the **Kalishman** case, supra, App. C.

The only distinguishing feature that the Fifth Circuit finds in the facts at hand from those in the **Saper** case, supra, is that the liquidating bankruptcy administration under Chapters I through VII of the Bankruptcy Act supersedes a Chapter XI proceeding effort to make an arrangement with unsecured creditors.

The effect of the rule imposed by the Fifth Circuit in this opinion in conflict with the **Kalishman** decision is that the trustee in liquidating bankruptcy must pay, prematurely, and out of turn, claims for taxes which are even inferior in dignity to the expenses of the bankruptcy administration itself under the prescribed priorities of Section 64. The alternative, of course, is to incur a continuing obligation for interest to be paid out of the estate to the prejudice of other creditors some of whom are on equal priority status as the claim of the government.

The Government's claim here as an "expense of administration" was accorded Class 1 priority under § 64 of the Bankruptcy Act. It is limited only by the fact that it is an expense of a superseded debtor relief proceeding. That fact makes this claim junior to the expenses of the administration necessary for the liquidating bankruptcy.

Section 64(a) qualifies the expense of administration priorities and treats those at issue in this proceeding as follows:

> "Where an order is entered in a proceeding under any Chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; . . ."

The taxes under consideration here for Withholding, FICA, FUTA and cabaret taxes became returnable at a time after the termination of the debtor in possession Chapter XI administration and during the period of administration of the liquidating trustee in bankruptcy. If interest is permitted on the taxes from the date they are returnable, notwithstanding the fact that it is a date within the administration of a liquidating bankruptcy, the trustee is then faced with a dilemma. A payment of taxes prematurely by the Trustee may be at the peril of reducing his estate and not having sufficient assets to pay administration expenses superior to the tax claim. The other alternative is not to have sufficent assets to pay the administration expenses of equal dignity with the tax claim, thus forcing on those creditors a fractional share when the government, on the same priority level, received its claim in full.

To delay payment and incur interest as required

by the ruling of the Fifth Circuit, may result in a diminution of the fractional shares of the claims of equal dignity and certainly is a penalty against claims of inferior dignity, including those for wages, taxes of other governmental authorities, rent and unsecured creditors. This principle of forcing premature payment of taxes under penalty of incurring interest is not only completely alien to ordinary bankruptcy procedure but it is inequitable to creditors and, petitioner contends, without foundation in applicable law. The arguments which support the requirement that interest be paid on taxes to force timely payment is absent in these circumstances. Admittedly, the imposition of interest is a logical requirement to motivate the taxpayer to pay taxes.

Saper, Kalishman and other authorities disallowing interest, recognize that the persuasive reasons for interest accruing on unpaid principal of taxes is absent in a liquidating bankruptcy proceeding. If the entity incurring liability continues to exist and operate, imposition of interest is a logical requirement to persuade such continuing entity to pay its taxes. By way of example, the liability surviving bankruptcy for non-dischargeable taxes, or the liability of a continuing trustee in bankruptcy receivership proceeding are reasonable subjects for interest imposition. The distinguishing features between the allowance of post-petition interest on entities other than a liquidating bankruptcy trustee was recognized by this court in **Bruning** v. **United States**, 376 U.S. 358, 11 L.Ed. (2) 772, 84 S.Ct. 906. There, the court allowed post-petition interest on a continuing obligation of a debtor inasmuch as taxes are non-dischargeable in bankruptcy. The court specifically acknowledged the logic and persuasiveness of the **Saper** ruling in the liquidating trus-

tee situation. **Boetler v. Ingels,** 308 U.S. 57, 84 L.Ed. 78, 60 S.Ct. 29, is another instance where penalties were allowed on taxes but such allowance was against an operating trustee. The operating trustee failed to obtain a license to continue his business and the penalties were upheld during the continuing of his administration. Not considered, however, was the imposition of the penalties on a later liquidating bankruptcy proceeding. The Fifth Circuit opinion in this case (R 33, Appx. A) cited **Boetler v. Ingels,** supra, as authority for the imposition of interest and penalties on the liquidating trustee in this particular case. The opinion, however, does not recognize the distinguishing nature of the liquidating bankruptcy procedure as opposed to the continuing entity of a Chapter XI debtor in possession or a trustee or receiver. This distinction was specifically recognized by this Court in **Bruning v. United States,** supra.

The motivation to pay taxes created by the imposition of interest on the principal amount is absent in its application to trustees in liquidating bankruptcy estates. The straight bankruptcy trustee has a specific duty under the law to gather the assets and allot to the government its proper statutory priority. All of these activities are under the supervision of the court, to which the government has access to compel the trustee to more expeditious activity if there is a delay unwarranted by the circumstances.

The distinguishing nature of the liquidating straight bankruptcy in contrast to the continuing trustee operating a business or other continuing entity raises another problem not acknowledged by the Fifth Circuit in the opinion entered in this cause.

The trustee in bankruptcy is required under the duties contained in the Act to collect the assets of the debtor and then make equitable distribution in pro rata shares recognizing the scale of priorities set out in the Act.

To properly carry out this responsibility, it follows that liability on the various claims must at some point cease and allocation of shares take place.

This principle is fundamental in liquidating bankruptcies and there is no reason that it should not be applicable to a liquidating bankruptcy that succeeds an unsuccessful debtor relief proceedings. The rule established by the Fifth Circuit in this instance singles out this one exception and ignores the compelling practical problems inherent in the ruling which will necessarily complicate conclusion of such superseded bankruptcy proceedings. See 3 Collier on Bankruptcy, page 1855.

III. BANKRUPTCY ACT SECTION 378(2) IS NOT AN IMPOSITION OF DUTIES ON A TRUSTEE IN BANKRUPTCY AND THE PROVISIONS HAVE NO APPLICATION IN THIS CONTEXT.

Section 378 of the Act (11 U.S.C. §778) contains two sections. Sub section (2) is underconsideration in these proceedings as the original petition of the Debtor, Beachcomber Motel, was for a debtor relief proceeding under Chapter XI of the Act, or a Section 322 petition (See Appx. B. page 13).

The Court of Appeals for the Fifth Circuit invoked the provisions of Section 378 to impose the continuing in-

terest liability on a Trustee in Bankruptcy for the unpaid withholding taxes and other taxes incurred by the predecessor debtor in possession. The holding of the Fifth Circuit additionally imposes on the Trustee in Bankruptcy through interpretation of Section 378 a responsibility to file returns for the taxes claimed by the Government as "administrative expense taxes". The same general line of argument that applies to the interest imposition on the Trustee in Bankruptcy also is followed with respect to the requirement to file tax returns. The **Kalishman** opinion, supra, appendix C, also considered Section 378(2) and its application to facts identical to those at issue here, but rejected the Government's contention that Section 378(2) imposed obligations on a straight bankruptcy Trustee.

The purpose of Section 378 is to implement the transition from an active debtor relief proceeding into a straight bankruptcy proceeding under Chapters I through VII of the Act. This section defines the time when the rights of the Trustee in Bankruptcy accrue and relates them back to the time of the original petition under Chapter XI. **Miller** v. **Woolley**, (C.A. 9, 1944), 141 F(2) 837, described the effect of Section 378 as a retroactive adjudication in bankruptcy following the interpretation that Section 378 is nothing more than a relation of the time when the rights of the Trustee accrue. **Wood** v. **Scott** (C.A. 6, 1950) 180 F(2) 252, made the same application of that section.

The relation back of Sec. 378 solves the problem of whether the trustee in bankruptcy succeeds to property rights as of the date of adjudication, or as of the date of adjudication, or as of the date of the filing of the petition. Such a determination is necessary since at numerous

places, such as §64 of the Bankruptcy Act, prescribing a priority for wages and landlord's claims, all defined in relation to a fixed period of time prior to the petition, as well as the question of when property rights vest in a trustee, the trustee's status must be fixed with reference to one of the two dates.

§378 of the Bankruptcy Act resolves this by an expression of Congressional determination that the trustee, in the vesting of rights and in the administration of the estate has all of the powers he would have had, had not a debtor's relief provision, possibly under the aegis of the debtor in possession, supervened. A District Court, in the matter of **Goodrich Manufacturing Co.**, (DC Cal.) 168 F. Supp. 940, recognized the intent of Section 378 by holding that the Administration under an aborted Chapter XI proceeding was not binding on a Trustee to the extent that the meeting of creditors under the Chapter XI would constitute the first meeting of creditors as required under the Chapters I through VII of the Act. The first meeting is the time from which the claim period begins to run.

Two significant propositions should be considered in the application of Section 378. First is that Section 378 by its own terms is not mandatory, but requires that the proceedings after adjudication should be conducted "so far as possible" as if the original petition for adjudication had been filed at the time that the debtor relief petition was filed. Secondly, it is certainly a revolutionary expansion of the duties of the Trustee as required by Section 47 of the Act Appx. 8 to impose on the liquidating Trustee, the responsibiliy of the operating Debtor in Possession, including liability for continuing interest that would have been the obligation of a debtor in possession.

In this instance, as applied by the Fifth Circuit, the entire scheme of priorities elaborately developed in Section 64 of the Act, is disrupted and the sound basic reasoning behind the rule denying post petition interest so well developed and accepted in **New York** v. **Saper** and its supporting cases.

The expansion of the scope of Section 378 beyond the mere fixing of the date from which the Trustee's rights accrue in his administration of the liquidating bankruptcy, is unwarranted by the language of the Section and inconsistent with a reasonable and orderly administration of the Act.

IV. THERE IS NO STATUTORY DUTY REQUIRING LIQUIDATING TRUSTEES IN BANKRUPTCY TO FILE TAX RETURNS ON BEHALF OF A PREDECESSOR DEBTOR IN POSSESSION

The tax return requirement contained in the opinion of the Fifth Circuit to which this petition is directed, imposes on a Trustee in Bankruptcy a duty to file on behalf of his predecessor debtor in possession a tax return by the debtor in possession for withholding taxes, Excise Tax, F.U.T.A. and F.I.C.A. taxes. There is no such duty imposed on a Trustee in Bankruptcy by those Revenue Statutes prescribing the filing of tax returns. The pertinent provisions of the Internal Revenue Code requiring filing of tax returns as to cabaret taxes are contained in 26 U.S.C.A., Section 4231, subsection 6, appendix 14. As to withholding, F.I.C.A. and F.U.T.A. the applicable section for the filing of returns is 26 U.S.C.A., Section 6011, appendix 15.

No place does Congress impose the responsibility for filing those returns on any person other than the person receiving the income or collecting the revenue.

In the facts before the Fifth Circuit concerning the Beachcomber Motel, the person receiving the income or collecting the revenue, of course, was the debtor in possession under the Chapter XI proceedings.

If the debtor in possession administration had continued to the date when the returns were due, it would have been its officers' duty to file the returns and pay the tax as it would have been a continuing entity under the interpretation of **Boetler** v. **Ingles**, supra. Likewise, if the Trustee had conducted the business and incurred tax liability for the various taxes involved here it would have been his responsibility to file returns by the direct application of 28 U.S.C., Section 960, App. 17. The latter section qualifies its application to trustees "conducting a business". There is, of course, no showing that this Trustee in Bankruptcy conducted a business in the process of liquidating the estate of Beachcomber Motel.

In fact the arrangement failed and an adjudication was entered when the debtor was dispossessed and the motel operation closed altogether.

An example of the direct Congressional enactment imposing on a Trustee in Bankruptcy the obligation to file returns for their predecessors is contained in 26 U.S.C., Section 6012, App. 15. This section, of course, applies only to income taxes. No comparable provision has been found in the Internal Revenue Statutes as to withholding

F.I.C.A., F.U.T.A., or the cabaret taxes under consideration in this proceeding.

It then follows that the penalties claimed by the Government for failure to file tax returns should not have been upheld by the Fifth Circuit as there is no statutory authority requiring the filing of those returns by the liquidating trustee in bankruptcy and they are certainly not listed as one of his duties under Section 47 of the Bankruptcy Act.

CONCLUSION

The judgment of the Fifth Circuit has made a serious departure from long established precedent, by its holding that certain claims in bankruptcy shall draw interest to date of payment.

This ruling necessarily complicates the administration of any trustee liquidating a bankrupt estate if the liquidation superseded a debtor relief proceeding. The fundamental principle that some point must be reached when the trustee can assess the assets and calculate pro-rata distributions to all creditors has been overthrown in this one single instance.

Additionally the rule of the Fifth Circuit poses the other practical problem of forcing a dilemma on a trustee to either pay certain tax claims prematurely or incur interest as a penalty for non-payment. Confusion necessarily results if the assets of the liquidated bankruptcy are limited and priority creditors are reduced to fractional distributions.

The practical implications of the Fifth Circuit's holding may be onerous but the inequities that result from the imposition of interest is the most significant result of the holding.

To follow the rule of permitting interest to accumulate on certain tax claims penalizes every other creditor of any bankruptcy proceeding which follows an unsuccessful debtor relief proceeding. Creditors of equal priority status in the "administrative expense" category can have their share diminished if the estate is limited and of course every junior class in the priority ladder will always be penalized.

Interest is primarily a penalty imposed to persuade timely payment of taxes. In a liquidating bankruptcy the reason for the rule of interest is absent, thus statutory authority for its imposition should be clear, specific and unambigious.

§378 of the Bankruptcy Act merely establishes a time when property rights of a trustee in bankruptcy begin and it is the only legislative mandate suggested to alter the tax claims in the Beachcomber case from those in any other liquidating bankruptcy.

Thus imposition of interest on these bankruptcy "administrative taxes" is unauthorized and clearly inconsistent with the Bankruptcy Act plan of distribution.

Likewise the requirement imposed by the Fifth Circuit for a trustee in bankruptcy to file tax returns for his predecessor is without specific statutory mandate.

The decision of the Fifth Circuit in conflict with the *Kalishman* decision of the Eighth Circuit in the same area should be reviewed by this court. The conflict should be resolved and the long established sound rule denying post petition interest in bankruptcy should be reaffirmed by a reversal of the judgment in this case.

Respectfully submitted;

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By:_____
JOHN H. GUNN

APPENDIX A

In The

UNITED STATES COURT OF APPEALS

For The Fifth Circuit

No. 21777

UNITED STATES OF AMERICA,

Appellant,

versus

JOHN NICHOLAS, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt,

Appellee.

Appeal from the United States District Court for the Southern District of Florida.

(May 25, 1965.)

Before TUTTLE, Chief Judge, RIVES and BELL, Circuit Judges.

TUTTLE, Chief Judge: On August 6, 1958, Beachcomer Motel, Inc., filed a petition for an arrangement proceeding under Chapter XI of the Bankruptcy Act. It was permitted to retain possession of the property as Debtor in Possession until, upon failure to submit an acceptable plan, the company was adjudicated a bankrupt

on September 17, 1958. During the intervening period of operation, the Debtor in Possession failed to make payment of certain taxes that accrued during this short period of operation. In fact, under the statute, the taxes that were collected or withheld for the quarter ending September 30, 1958, were not required to be included in returns to be filed until October 31, 1958. Others were to be returned by January 31, 1959. By this time, of course, the Trustee in Bankruptcy had succeeded to the duties of the former Debtor in Possession.

The Trustee failed to make the required returns and the Government filed an administrative expense statement of the taxes due covering the following amounts: $519.89 of withholding and FICA taxes (Federal Insurance Contributions Act) accruing between August 6, 1958, when the petition for arrangement was filed and September 17, 1958, when the taxpayer was adjudicated a bankrupt; $644 of cabaret excise taxes also accruing between the same dates, and $362.29 of FUTA (Federal Unemployment Tax Act) accruing during 1958. The aggregate of these items is $1,526.18.

Additionally, the United States stated as administrative expense, assessed interest on each of the three principal items above set forth in the amounts of $101.54, $17.58, and $4.46, respectively, totalling $123.58. These two sums, $1,526.18 principal amount of tax and assessed interest of $123.58, totalling $1,649.76, were allowed by the referee as an administrative tax claim entitled to first priority.

However, the referee sustained the trustee's objection to the Government's claim No. 51 as to the amounts set

forth as alleged penalties and accrued interest. Thus, the referee disallowed the following amounts contained in the Government's administrative expense statement of taxes due; namely, assessed penalty on the withholding and FICA taxes in the amount of $129.97, on the excise taxes in the amount of $161, and on the FUTA in the amount of $54.34, aggregating $345.31. The referee also disallowed interest after the date of the assessment and accrued to April 10, 1963 (the day before the date of filing of Claim No. 51) on the withholding and FICA taxes in the sum of $46.34, on the amount of excise taxes in the sum of $192.35, and on the amount of FUTA taxes in the sum of $99.55, totalling $338.24. Claim No. 51 also sought interest on the amounts due at the rate of 31 cents per day from April 11, 1963, the date of the filing of the claim.

The referee, as already stated, allowed as an administrative expense entitled to a first priority the principal amounts of the taxes and assessed interest. Thus, the only controversy here is with respect to his disallowance of the items of assessed penalties totalling $345.31 and interest accrued after the date of assessment, totalling $338.24, in all, $683.55 together with interest from April 11, 1963.

Upon a petition for review filed by the United States from the disallowance of these penalties and interest, the District Court affirmed the order of the referee.

As the Government points out, the distinction between taxes which accrue against a taxpayer prior to bankruptcy and those which accrue against a trustee after bankruptcy, has become well settled. Pre-bankruptcy taxes are pay-

able as tax claims against the bankrupt's estate under §57 of the Bankruptcy Act. 11 U.S.C.A. §93. They are entitled to payment as of the Fourth priority under §64a of the Act, 11 U.S.C.A. §104. If, however, a trustee becomes subject to taxes as a result of operations carried on after bankruptcy, these taxes constitute an expense of administration under §62a of the Act and, as such, are payable as a First priority under §64a.

The duty of the trustee in bankruptcy to pay taxes which accrue during the course of his administration, independent of tax claims which had accrued prior to bankruptcy, has long been recognized by the Supreme Court. See **Michigan v. Michigan Trust Co.**, 286 U.S. 334. Here, of course, the referee recognized this obligation, and properly required the payment of the principal amount of the taxes as an expense of administration. He drew the line, however, at the payment of interest on this principal amount of the taxes and additions to the tax, commonly called a penalty, arising from the failure of the trustee to make the necessary returns and payments on time.

The trustee here contends that since the taxes accrued while the Debtor in Possession was operating the corporation later to become bankrupt, rather than the trustee after bankruptcy, the taxes that accrued during this period should be treated as pre-bankruptcy taxes as should also, of course, the interest and penalties, if they are payable at all, when the failure to make the proper returns and payments is a failure of the bankruptcy trustee. As the Government points out, however, when a debtor is permitted to retain his possession under a Chapter XI arrangement proceeding, he is, within con-

templation of the law, just like a trustee, certainly to the extent of his obligation and duty to do the things that the statute would require of a trustee in possession. In fact, where a plan for arrangement turns out to be unsuccessful and an adjudication of bankruptcy is entered, §3782 of the Act provides that "the proceedings shall be conducted, so far as possible, in the same manner and with like effect, as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this Chapter was filed; . . ." 11 U.S.C. §778. See **United States v. Sampsell**, 9 Cir., 193 F.2d 154. See also 8 Coll. on Bankruptcy (14 Ed. 1963 Rev.) Secs. 6.31 and 6.32 which states "the general purpose of §342 is that where a debtor continues in possession of his property, he shall be in fact a trustee. 'Its position as debtor, continued in possession, is for all practical purposes that of a trustee or receiver . . .' 'A debtor continued in possession by court order is a court officer analogous to a receiver or trustee.' A debtor in possession 'has all the powers of an ordinary trustee . . .'"

Thus, it is plain that the obligation of the trustee here was the same as if he had been in possession from the filing of the original Section XI proceedings. This being the case, it appears that the leading decision **Boteler v. Ingels**, 308 U.S. 57, answers the basic question whether the trustee is liable to the same obligation to make required returns and payments upon penalty of suffering additions to the tax that a private tax-payer would face. We think it clear that he is so subject. The Supreme Court said in that case, "if businesses in California not conducted by a bankruptcy trustee are delinquent in the fees, they must pay the penalty. However, petitioners

contention would exempt a trustee operating a business in bankruptcy from this double-tax liability which other delinquents must bear. A state would thus be accorded the theoretical privilege of taxing businesses operated by trustees in bankruptcy on an equal footing with all other businesses, but would be denied the traditional and almost universal method of enforcing prompt payment." (p. 61)

We conclude that the principle announced in the **Boteler** case clearly applies here to the federal impositions. Thus, it follows that the referee and the trial court erred in not including the items listed above as costs and expenses of administration and thus payable under the First priority.

The judgment is REVERSED and the case is REMANDED for further proceedings not in consistent with this opinion.

[TITLE OMITTED]

JUDGEMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was urged by Counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and that this cause be, and it is hereby remanded to the said District Court for further proceedings not inconsistent with the opinion of this Court.

[TITLE OMITTED]

Issued as Mandate: May 25, 1965

(JULY 9, 1965)

ON PETITION FOR REHEARING

Before TUTTLE, Chief Judge, RIVES and BELL, Circuit Judges.

PER CURIAM:

It is ORDERED that the petition for rehearing filed in the above styled and numbered cause be, and the same is, hereby DENIED.

[TITLE OMITTED]

ON CONSIDERATION OF THE APPLICATION of the Appellee in the above numbered and entitled cause for a stay of the mandate of this court therein, to enable Appellee to apply for and to obtain a writ of certiorari from the Supreme Court of the United States, IT IS ORDERED that the issue of the mandate of this court in said cause be and the same is stayed for a period of thirty days; the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within thirty days from the date of this order there shall be filed with the clerk of this court the certificate

of the clerk of the Supreme Court that certiorari petition and record have been filed. It is further ordered that the clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon the expiration of thirty days from the date of this order, unless the above-mentioned certificate shall be filed with the clerk of this court within that time.

DONE AT NEW ORLEANS, LA., this 23rd day of July, 1965.

/s/ ELBERT P. TUTTLE
Chief Judge

(ORIGINAL FILED JULY 23, 1965)

APPENDIX B

The Statutes and Regulations necessary for consideration of the issues involved.

11 U.S.C. §75(a) (Sec. 47a Bankruptcy Act) Trustees; duties.

> (a) Trustees shall (1) collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, and close up the estates as expeditiously as is compatible with the best interests of the parties in interest; (2) deposit all money received by them in designated depositories initially in demand deposits; and subsequently, if authorized

by the court, in interest-bearing savings deposits, time certificates of deposit, or time deposits-open account; (3) account for and pay over to the estates under their control all interest received by them upon funds belonging to such estates; (4) disburse money only by check or draft on such depositories; (5) keep records and accounts showing all amounts and items of property received and from what sources, all amounts expended and for what purposes and all items of property disposed of; (6) set apart the bankrupts' exemptions allowed by law, if claimed, and report the liens and estimated value thereof to the courts as soon as practicable after their appointment; (7) examine the bankrupts (a) at the first meetings of creditors or at other meetings specially fixed for that purpose, unless they shall already have been fully examined by the referees, receivers, or creditors, and (b) upon the hearing of objections, if any, to their discharges, unless otherwise ordered by the court; (8) examine all proofs of claim and object to the allowance of such claims as may be improper; (9) oppose at the expense of estates the discharges of bankrupts when they deem it advisable to do so; (10) furnish such information concerning the estates of which they are trustees and their administration as may be requested by parties in interest; (11) pay dividends within ten days after they are declared by the referee; (12) report to the courts in writing the condition of the estates, the amounts of money on hand, and such other details as may be required by the courts, within the first month after

their appointment and every two months thereafter, unless otherwise ordered by the courts; (13) make final reports and file final accounts with the courts fifteen days before the days fixed for the final meetings of the creditors; and (14) lay before the final meetings of the creditors detailed statements of the administration of the estates.

11 U.S.C. §104 (Sec. 64 Bankruptcy Act) Debts which have priority.

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estates subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under Chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable

under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the

their appointment and every two months thereafter, unless otherwise ordered by the courts; (13) make final reports and file final accounts with the courts fifteen days before the days fixed for the final meetings of the creditors; and (14) lay before the final meetings of the creditors detailed statements of the administration of the estates.

11 U.S.C. §104 (Sec. 64 Bankruptcy Act) Debts which have priority.

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estates subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, is recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of the recovery; the trustee's expenses in opposing the bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under Chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable

under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases, and to the petitioning creditors in involuntary cases, and if the court adjudges the debtor bankrupt over the debtor's objection or pursuant to a voluntary petition filed by the debtor during the pendency of an involuntary proceeding, for the reasonable costs and expenses incurred, or the reasonable disbursements made, by them, including but not limited to compensation of accountants and appraisers employed by them, in such amount as the court may allow. Where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the

term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commission basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under Chapter 9 of Title 18, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; **Provided,** That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: **And provided further,** That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law:

Provided, however, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

11 U.S.C. §778(2) (Sec. 378(2) Bankruptcy Act). Procedure upon order directing that bankruptcy be proceeded with.

Upon the entry of an order directing that bankruptcy be proceeded with—

(1) in the case of a petition filed under section 721 of this title, the bankruptcy proceeding shall be deemed reinstated and thereafter shall be conducted, so far as possible, as if such petition under this chapter had not been filed; and
(2) in the case of a petition filed under section 722 of this title, the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed; and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed as provided in section 72 of this title.

Internal Revenue Code of 1954:

26 U.S.C. Sec. 3504. Acts to be performed by agents. (As amended by Sec. 71, Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606)

In case a fiduciary, agent, or other person has the control, receipt, custody, or disposal of, or pays the wages of an employee or group of employees, employed by one or more employers, the Secretary or his delegate, under regulations prescribed by him, is authorized to designate such fiduciary, agent, or other person to perform such acts as are required of employers under this title and as the Secretary or his delegate may specify. Except as may be otherwise prescribed by the Secretary or his delegate, all provisions of law (including penalties) applicable in respect of an employer shall be applicable to a fiduciary, agent, or other person so designated but, except as so provided, the employer for whom such fiduciary, agent, or other person acts shall remain subject to the provisions of law (including penalties) applicable in respect of employers.

26 U.S.C. Sec. 4231. (6)—Cabarets.

A tax equivalent to 20 percent of all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of

such performance. The tax imposed under this paragraph shall be returned and paid by the person receiving such payments. No tax shall be applicable under paragraph (1) or (2) on account of an amount paid with respect to which tax is imposed under this paragraph.

26 U.S.C. Sec. 6011. (a)—General requirement of return, statement, or list.

(a) General rule—When required by regulations prescribed by the Secretary or his delegate any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary or his delegate. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

26 U.S.C. Sec. 6012 (b)(3)—Receivers, trustees and assignees for corporations.

In a case where a receiver, trustee in bankruptcy, or assignee, by order of a court of competent jurisdiction, by operation of law or otherwise, has possession of or holds title to all or substantially all the property or business of a corporation, whether or not such property or business is being operated, such receiver, trustee, or assignee shall make the return of income for such corporation in the same manner and form as corporations are required to make such returns.

26 U.S.C. Sec. 6601(a). Interest on underpayment, nonpayment, or extensions of time for payment, of tax.

(a) General Rule. If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

26 U.S.C. Sec. 6651. Failure to file tax return.

(a) Addition to the tax. In case of failure to file any return or required under authority of subchapter A of chapter 61 (other than part III thereof), of subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), or a subchapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), or of subchapter A of chapter 53 (relating to machine guns and certain other firearms), on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

28 U.S.C. Sec. 960. Tax liability.

Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

Treasury Regulations on Employment Tax (1954 Code):

§31.6071(a)—1 Time for filing returns and other documents. (a) Federal Insurance Contributions Act and income tax withheld from wages. (1) Quarterly or Annual returns. Each return required to be made under §31.6011 (a)—1, in respect of the taxes imposed by the Federal Insurance Contributions Act, or required to be made under §31.6011 (a)—4, in respect of income tax withheld, shall be filed on or before the last day of the first calendar month following the period for which it is made. However, any such return may be filed on or before the tenth day of the second calendar month following such period if such return is accompanied by depositary receipts, Form 450, showing timely deposits in full payment of such taxes due for such period. For the purpose of the preceding sentence, a deposit which is not required to be made within such return period may be made on or before the last day of the first calendar month following the close of such period, and the timeliness of the deposit for any month will be determined by the earliest date stamped on the validated Form 450 by an authorized commercial bank or by a Federal Reserve bank.

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

No. 17,780

UNITED STATES OF AMERICA,
Appellant,

v.

JEROME KALISHMAN, Trustee in Bankruptcy of Seymour Wallas and Company, Bankrupt,
Appellee.

Appeal from the United States District Court for the Eastern District of Missouri.

[June 4, 1965.]

Before Vogel, Matthes and Ridge, Circuit Judges.

Ridge, Circuit Judge.

The sole question presented by this appeal is whether the United States is entitled to interest until date of payment of withholding taxes which accrued against the debtor while in possession of the business under an arrangement proceeding, and the interest did not begin to run on the tax until after the final adjudication in bankruptcy. Despite this simple statement of the problem here confronting us, the present case required an exhaus-

tive analysis of the present state of the law regarding post-bankruptcy interest claims. As appellee admits that "Appellant's statement of the case is essentially correct," the following facts are culled therefrom.

Seymour Wallas and Company, a corporation, filed a petition for an "arrangement" on June 24, 1960. Thereafter, it was adjudicated a bankrupt on March 16, 1961, having failed to submit an acceptable plan. On September 15, 1961, the United States filed a claim for taxes, separated into two claims—one for taxes accruing before the arrangement proceeding,—the other for taxes accruing during the arrangement. The latter claim is the only one in issue here. It was for assessed withholding taxes of $6,602.89 for the first quarter of 1961, plus $202.38 interest to the date of filing the claim, and interest of $1.06 per day thereafter until payment of the principal was made—ultimately on May 6, 1964. These taxes were not required to be reported or paid until April 30, 1961, subsequent to the adjudication in bankruptcy after failure of the arrangement proceeding; hence the interest here did not begin to accrue until that date. The Referee allowed the tax claim in the principal amount of $6,602.89 as an expense of administration of the arrangement proceeding but denied the claim for interest, basing his decision on *City of New York* v. *Saper*, 336 U.S. 328, 69 S.Ct. 554, 93 L.Ed. 710 (1949). On petition for a review, the District Court affirmed in an unreported order. This appeal followed.

At the outset we are met with a jurisdictional question, raised by appellee in view of §24(a) of the Act,[1]

[1] 11 U.S.C.A. § 47(a).

which limits appeals in bankruptcy proceedings to matters involving more than $500.00 unless prior allowance of the appeal has been granted by the Court of Appeals. (See Rule 25 of this Court, 28 U.S.C.A., Rules, 8 Cir.) Since appellant claims interest to date of payment, it is readily apparent that substantially more than $500.00 is in issue here, even though the amount claimed was less than that sum at the time of filing the claim.[2] Regardless, this is an appeal which we can, and should, hear in our discretion, in the interest of substantial justice. *R.F.C.* v. *Prudence Group*, 311 U.S. 579, 61 S.Ct. 331, 85 L.Ed. 364 (1941); *New York Credit Men's Adjustment Bureau, Inc.* v. *Strauss & Co.*, 296 F.2d 702 (2 Cir., 1961). It is of sufficient importance to the future administration of the Bankruptcy Act(hereinafter denominated Act) to warrant our consideration thereof on its merits. *State of California* v. *Renauld & Co.*, 179 F.2d 605 (9 Cir., 1950).

Neither party questions the allowance of the principal amount of the taxes here considered as a proper expense of administration of the arrangement proceeding, entitled to a first priority under §64(a)[3] of the Act. They are taxes incurred while the property of the debtor was *in custodia legis* under the administration of the bankruptcy court, and thus are clearly expenses of administration as that term has long been understood. Cf. *Dayton* v. *Stanard*, 241 U.S. 588, 36 S.Ct. 695, 60 L.Ed. 1190 (1916); *State of Missouri* v. *Gleick*, 135 F.2d 134 (8 Cir., 1943); *United States* v. *Sampsell*, 266 F.2d 631 (9 Cir., 1959). See also, 3 Collier on Bankruptcy §64.105, p. 2088. It is appellant's contention that since under normal circum-

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[2] The accrued interest now claimed by the Government amounts to $1,172.28.

[3] 11 U.S.C.A., ¼ 104(a).

stances interest on unpaid taxes is considered an integral part of a tax liability itself, the interest here in issue should equally share that preferred status unless the fact of bankruptcy on the part of the taxpayer requires a different result.

In bankruptcy matters the Bankruptcy Act takes precedence over other statutes, and governs in any case where there might be conflict. *Guarantee Title & T. Co.* v. *Title Guaranty & S. Co.*, 224 U.S. 152, 32 S.Ct. 457, 56 L.Ed. 706 (1912); *Adams* v. *O'Malley*, 182 F.2d 925 (8 Cir., 1950); *United States* v. *Wood*, 290 Fed. 109 (2 Cir., 1923), aff'd 263 U.S. 680, 44 S.Ct. 133, 68 L.Ed. 503. Thus, in the matter of priorities the courts are bound by the terms of the Act, regardless of other statutory preferences. *Missouri* v. *Ross*, 299 U.S. 72, 57 S.Ct. 60, 81 L.Ed. 46 (1936); *Davis* v. *Pringle*, 268 U.S. 315, 45 S.Ct. 549, 69 L.Ed. 974 (1925). Present §64(a) of the act, *supra*, represents a clear departure from pre-Chandler Act practice, in that it reduces all costs and expenses of administration to a parity; that is, taxes no longer have a special priority over any other expenses of administration, all of which now share the same priority on an equal basis. *Missouri* v. *Earhart*, 111 F.2d 992 (8 Cir., 1940); *In re Columbia Ribbon Co.*, 117 F.2d 999 (3 Cir., 1941). Therefore, our consideration of post-bankruptcy interest in this tax claim can be no different than that of interest accruing generally as cost of administration on other like claims.

Considering interest in connection with bankruptcy, it appears that there is a ". . . long-standing rule against post-bankruptcy interest . . . implicit in our current Bankruptcy Act." *New York* v. *Saper*, l.c. 332. *In Vans-*

ton Committee v. *Green*, 329 U.S. 156, l.c. 163, 67 S.Ct. 237, 91 L.Ed. 162 (1946), the Court stated: "The general rule in bankruptcy . . . has been that interest on the debtors' obligations ceases to accrue at the beginning of proceedings." As said in *Bruning* v. *United States*, 376 U.S. 358, at 361-362: "As to claims against the trustee in bankruptcy, the general rule for liquidation of the bankruptcy estate has long been that a creditor will be allowed interest only to the date of the petition in bankruptcy . . ." and that *Saper*, *supra*, makes the general rule (applicable) "to claims against the trustee for taxes as well as for other debts." As the Court, in *Vanston Committee* v. *Green*, pointed out, this is a matter of equity . . . the delay in distribution being caused by law, and the estate should not be penalized for the delay by additional interest. In this connection, see *Sexton* v. *Dreyfus*, 219 U.S. 339, 31 S.Ct. 256, 55 L.Ed. 244 (1911); *United States* v. *Bass*, 271 F.2d 129 (9 Cir., 1959; *Massachusetts* v. *Thompson*, 190 F.2d 10 (1 Cir., 1951); 3 Collier on Bankruptcy, §63.16, p. 1858. There is also a matter of administrative convenience, as the very purpose of a "cut-off" or "bar" date would be thwarted if obligations are allowed to accrue past that date, continuing the vicious circle which bankruptcy was designed to terminate. This is not to say that such post-bankruptcy interest may never be allowed, for it is settled that the creditors' rights thereto will be recognized should the estate subsequently prove to be solvent, or should the estate itself subsequently receive income in the form of interest. *United States* v. *Harrington*, 269 F.2d 719 (4 Cir., 1959). We realize that the foregoing cases deal with interest which began to accrue prior to bankruptcy, on debts likewise accruing. Be that as it may, we think the broad policy and reasons therefor, toward post-bankruptcy interest,

should be kept in mind in the consideration of the specific issue in question here.

In the instant case we deal with a debt incurred as an expense of administration by a debtor in possession, the interest on which did not begin to accrue until after a subsequent adjudication in bankruptcy. By virtue of §378(2)[4] of the Act, the abortive arrangement proceeding and the subsequent bankruptcy are considered parts of a single proceeding so far as possible, and we must consider the debt here incurred by the debtor in possession as though it were contracted by the trustee during bankruptcy.

There is no question, of course, that a trustee is liable for taxes incurred during the administration of the estate, whether resulting from continuing to do business, or simple ad valorem taxes on the property in the estate. *Boteler* v. *Ingels*, 308 U.S. 57, 60 S.Ct. 29, 84 L.Ed. 78 (1939); *In re Chicago & N.W. Ry. Co.*, 119 F.2d 971 (7 Cir., 1941); *State of Missouri* v. *Earhart*, *supra*. Here, the question very simply is whether the Government is entitled to interest on such taxes after straight bankruptcy has been adjudicated, until the date of payment of the taxes accruing during an arrangement proceeding.

In 1949, the Supreme Court handed down the decision in *City of New York* v. *Saper*, *supra*. Since that time, the *Saper* decision has been variously considered in lower federal courts on numerous occasions. Such cases, of which the present is apparently the latest, involved the contention that the very broad language of *Saper* should

[4] 11 U.S.C.A., § 778(2).

be restricted to the specific situation involved there, but it should be noted that in each case thereafter the courts have taken the language of *Saper* at face value and accepted the rationale thereof, wherever logically required to do so. See, for example, *United States* v. *General Engineering & Mfg. Co.*, 188 F.2d 80 (8 Cir., 1951), aff'd 42 U.S. 912, 72 S.Ct. 357, 96 L.Ed. 682; *United States* v. *Edens*, 189 F.2d 876 (4 Cir., 1951), aff'd 342 U.S. 912; *State of New York* v. *Feinberg*, 204 F.2d 502 (2 Cir., 1953).

The *Saper* case involved the question of post-bankruptcy interest on taxes accruing prior to straight bankruptcy. The Court, in denying such interest, noted that prior to the Chandler Act, interest was commonly allowed, based on the especially preferred status of taxes under the Act of 1898, and further, that lower federal courts had continued to do so even after the Chandler Act. However, in *Saper* it clearly held such practice to be in error, as being in violation of the long-standing bankruptcy tradition that accrual of interest against the estate ceases on the inception of bankruptcy as a matter of equity and practicality. Each of the cases subsequently considering *Saper* have likewise been concerned with straight pre-bankruptcy tax debts, and we are not cited to, nor have we found any subsequent cases specifically dealing with an issue situation such as here present. We think it necessary to remember, however, that the Court in *Saper* considered with favor the "long-standing rule" against post-bankruptcy interest based on equitable considerations.

Appellant asserts that *Boteler v. Ingels, supra*, is authority for allowance of the interest attempted to be collected here. In that case the Court held that a trustee

in bankruptcy was liable for state penalties imposed for nonpayment of automobile license fees when the fees and penalties accrued during the operation of the business by the trustees for the purposes of liquidation. We are also referred to *In re Chicago & N.W. Ry. Co., supra*, holding, on the authority of *Boteler*, an estate in bankruptcy was liable for the penalties on overdue state taxes accruing after the institution of the bankruptcy proceedings. Both of the above cases were mainly premised on the provisions of the predecessor statute of 28 U.S.C.A., §960, which provided generally the same as present §960.[5] The reasoning of the Court in the above-cited cases was that §57(j)[6] was applicable only to penalties incurred by the bankrupt individually prior to bankruptcy, and that it was not applicable to penalties brought on by the action of the trustee himself. In such instance, the provisions of §960 of Title 28 were held to prevail. Without speculating as to the "intent" of the Supreme Court in *Saper* (which opinion did not mention *Boteler*), we believe the present case to be distinguishable from *Boteler*, and to come under the reasoning laid down in *Saper* without doing violence to *Boteler*. Our understanding of *Boteler* is that it holds simply that a trustee operating a business is subject to tax statutes, the same as any other citizen, and subject to penalties if he does not comply with the law. Such is not the issue in the present case.

Here, we deal with "interest" after adjudication, within the concept of ". . . compensation for the use of forbearance of money." *Deputy* v. *duPont*, 308 U.S. 488,

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[5] "Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation." 28 U.S.C.A. § 960.

[6] 11 U.S.C.A., § 93(j).

498, 60 S.Ct. 363, 84 L.Ed. 416 (1940); *C.I.R.* v. *Meyer*, 139 F.2d 256 (6 Cir., 1943). *Boteler* deals with a "penalty" as punishment for wrongdoing. *United States* v. *Chouteau*, 102 U.S. 603, 26 L.Ed. 246 (1881); *Unemployment Reserves Commission* v. *Meilink*, 116 F.2d 330 (9 Cir., 1940). The long-standing rule followed in *Saper* is concerned with interest after adjudication, not penalties as accrued in *Boteler*. Certainly, no argument can be made that malfeasance by a trustee in bankruptcy is never to be allowed pecuniary reimbursement in a bankrupt estate, to the extent of actual loss caused thereby, if the trustee undertakes to act contrary to law. This is what is ruled in *Boteler*. Here, appellant's claim is wholly related to the concept of interest (i.e. reimbursement for the use of money), which interest commenced to run after the date of adjudication in bankruptcy. True, the statute *supra* gives taxes a priority . . . and they are to be paid as soon as possible . . . If not so paid in a straight bankruptcy proceeding, any delay therefor can only be traced as caused by the law, not by the bankruptcy estate. This is the important distinction we find in the facts here. Paying taxes at the normal distribution time for debts of like priority, as ordered by the Court, creates quite a different situation than the affirmative violation of operating motor vehicles on the highways of a state without paying the necessary state motor vehicle license taxes.

Bruning v. *United States*, *supra*, does not require a *contra* ruling. There, interest on tax claims for the period from the filing of a petition in bankruptcy to the date of payment of the principal tax claim was recovered by the Government out of assets personally acquired by the tax debtor *after* his adjudication of bankruptcy, in the light of §6873(a) of the Internal Revenue Code of 1954 (26

U.S.C.A. §6873(a)). The facts and applicable law in *Bruning* do not militate against the ruling made in *Saper*. As the Court points up in *Bruning*, that "case concerns the debtor's personal liability for post-petition interest on a debt for taxes which survives bankruptcy to the extent that (the tax) is not paid out of the estate." (Par. added.) 376 U.S., l.c. 362. Here, we are concerned with pro rata distribution of assets of a bankrupt's estate among preferred creditors, having equal priority as required by §64(a) of the Bankruptcy Act, *supra*.

Appellant's argument that this interest should be enforced because of the trustee's willful refusal to pay the tax immediately when due, is without merit. The Government, as a creditor in bankruptcy, occupies no favored position over other creditors of like priority. *State of Missouri* v. *Earhart*, *supra*. There is nothing in this record to suggest that the tax in question was not given the same consideration as other costs of administration which occupied the same priority. To allow this interest would be in effect to charge the estate with interest, because the trustee complied with the terms of the Bankruptcy Act and refused to give the taxes a special priority not sanctioned by the Act. Allowing this interest would be to place the trustee in the unenviable position of being forced to choose between his responsibility to conserve the estate, and creating a new priority for taxes, or strictly abiding by the statutory scheme for the payment of all debts of equal priority in bankruptcy estates.

Whether the tax accrued before bankruptcy or subsequent thereto, the evil propagated by continually accruing interest remains the same. In neither case is it logical to charge a bankrupt estate a fee for the use of money when

it is the force of law which prevents the return of the principal to the creditor, rather than the desire of the debtor to retain its use. In light of the policy enunciated in *Saper*, we believe the referee was correct in denying interest on this tax claim. *Collectibility of Post-Bankruptcy Interest*, by Max Schwartz, Vol. 36, No. 2, p. 49, Jour. Nat'l Ass'n of Referees in Bankr.

In the alternative, the Government asserts that by the principal amount of the tax here withheld, and the interest thereon, constitute a trust fund in the hands of the trustee to which the United States as *cestui* has an absolute right, independent of any questions of priority, citing: *City of New York* v. *Rassner*, 127 F.2d 703 (2 Cir., 1942), construing a city ordinance making the vendor a trustee when collecting city sales tax from vendees; and *United States* v. *Sampsell*, 193 F.2d 154 (9 Cir., 1951), construing the predecessor statute of present §7501(a), *supra; Hercules Service Parts Corp.* v. *United States*, 202 F.2d 938 (6 Cir., 1953), as to withholding tax; and *In re Airline-Arista Printing Corp.*, 156 F.Supp. 403 (D.C. N.Y., 1957), aff'd 267 F.2d 333, also concerning withholding tax. These cases, all following *New York* v. *Rassner*, *supra*, hold that withheld tax funds constitute trust funds in favor of the taxing authority. Although the argument against allowing such statutory trusts to change the scheme of priorities in the Act is quite convincing,[8] we do not believe that question is present in this case. Whether or not these withheld funds constituted a trust fund for the benefit of the United States is rendered moot

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7 "(a) General Rule.—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of the tax so collected or withheld shall be held to be a special fund in trust for the United States . . ."

8 See Note 27, p. 2066, 3 Collier on Bankruptcy.

by the fact that the principal of the fund is not in issue here, and has in fact been paid over to the Government. As we have determined that the Government is not entitled to interest as here claimed, there are no further funds in issue, and thus no reason to reach the question as to whether or not a trust was created.

For the reasons noted, the decree of the referee as adopted by the District Court is

Affirmed.